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International Economic & Energy Weekly 25X1

Synopsis

Perspective—*An Oil Price Drop and US Influence* 25X1

A sharp drop in oil prices would create an environment that, in general, would work to US favor. How this translates into specific lines of influence or leverage is difficult to measure. Many of these opportunities would arise because of the adverse impact of lower oil prices on the USSR. 25X1

An Oil Price Drop: Opportunities for the United States 25X1

A sharp drop in oil prices would spark far-reaching changes in the international economic and political order. What this would mean in terms of US influence is difficult to assess, but the nature of US strategic concerns would shift, perhaps substantially in some parts of the world. 25X1

European Community: Protectionist Trends 25X1

Double-digit unemployment and growing import competition in both declining traditional industries and developing high-technology industries is prompting the EC to increase protectionist measures. The Community is relying primarily on export restraint agreements to limit imports. The EC has concentrated its protective efforts against Japan and the newly industrialized countries. 25X1

West Germany: Keeping Protectionism in Low Gear 25X1

The West German Government, traditionally a vocal advocate of free trade, is being pressured by some labor unions and employer groups to adopt protectionist measures. Rising import penetration, record unemployment, and Bonn's perception of growing isolation within the EC on trade policy are working to sap government resistance. The new Kohl government is hoping that a global economic recovery eventually will boost export opportunities and reduce the calls to ercct import barriers at home and abroad. 25X1

The Soviet Economy in 1982 25X1

The Soviet economy grew by 2 percent in 1982; farm output improved, while industrial growth continued to deteriorate. Andropov's efforts to improve labor productivity through his "disciplinary campaign" probably will lead to a more rapid growth in industrial output in the short run. This, together with average to good weather, could well boost GNP in 1983. The outlook in 1984 and beyond, however, will be clouded by continued shortages of industrial materials and transportation and smaller additions to the labor force. 25X1

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Perspective

An Oil Price Drop and US Influence

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A sharp drop in oil prices would create an environment that, in general, would work to US favor. How this translates into specific lines of influence or leverage is difficult to measure. Many of these opportunities would arise because of the adverse impact of lower oil prices on the USSR: Soviet hard currency earnings would drop sharply—by as much as $7 billion with $20 oil—forcing Moscow to cut military and economic aid to client and would-be client states.

From a regional perspective, the primary opportunities created by lower oil prices are in ***Sub-Saharan Africa***:

- In West Africa, Moscow may be even less able to maintain its position in Guinea and would have trouble exploiting the situation in Ghana.
- In southern Africa, the Soviets may have to toughen terms on military assistance.
  - —Moscow is already doing this in Tanzania and Zambia. With Tanzania's economy in a tailspin, the Tanzanians may sour on the socialist model.
  - —Angola would suffer a major loss in revenues from oil, which is already providing an opening for Western assistance.
  - —There may be a similar opening in Mozambique.
- In the Horn, an oil price decline may force a drop in Soviet aid to Ethiopia.

In ***Latin America,*** we see a few opportunities to enhance US influence:

- The United States is already helping finance the Mexican and Brazilian economies. We doubt that even another $5 billion would buy much more leverage than now exists.
- Venezuela may offer more opportunities because of its connections in Central America and the Caribbean. As Venezuelan funds dry up, the United States could score sizable political gains for relatively small sums of money by helping to subsidize the Venezuelan-Mexican oil facility.
- In Suriname, the Cuban hold is far from firm. Castro will probably not want to commit much money because of his own economic problems and the volatility of the situation in Suriname.

Opportunities for leverage uniquely related to an oil price decline appear few in ***South*** and ***Southeast Asia***:

- Indonesia will require large-scale assistance—either directly or through banks and the IMF. Providing the money may not enhance our influence, but withholding it or imposing tight conditionality might create instability.
- In Pakistan, the United States may be called upon to make up shortfalls in Saudi aid and other oil-related revenues.
- As for India, we do not believe an oil price decline would create any good opportunities to exploit.

A steep oil price drop would likely present more pitfalls than opportunities in the ***Middle East***:

- It would destabilize the already tenuous alliances among the countries in the region.
- The Saudis would feel more vulnerable to Iranian and Libyan attempts to foment unrest.
- A major risk is that the Saudis will cut aid to friendly governments and groups. Qadhafi would be able to maintain his terrorist and subversive activities at current levels.
- The chief opportunities for the United States would stem from whatever erosion there is in Moscow's ability to maneuver in the region.

In the case of our ***industrial country allies,*** we cannot identify any specific leverage that would result from a large drop in oil prices, but we can see two potential problems:

- There could be a major shift in West European attitudes toward development of North Sea gas; it would be more difficult to justify on strictly financial grounds if oil prices dropped. In this case, Soviet gas—particularly in the 1990s—would become more attractive.
- In an environment of economic recovery and reduced oil prices, the West Europeans might want to resume large loans to the USSR and Eastern Europe, in part because much of the reduction in Soviet oil revenues would translate into reduced purchases in Western Europe.

There is a potential for using the oil-exporting countries' need for financial assistance as a lever to obtain their commitment for minimum levels of oil production. Otherwise, the IMF, the industrial countries, and international financial institutions would in effect be subsidizing OPEC.

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Briefs

Energy

OPEC Production Continues Slide

OPEC production averaged 15.1 million b/d in February, down 2 million b/d since January and the lowest level in more than a decade. We believe production has slipped even lower in March as oil companies continue to draw down crude inventories at a rate of 5-6 million b/d in anticipation of a price reduction by the cartel. Saudi Arabia experienced nearly a 1-million b/d drop in oil production to about 3.8 million b/d. Nigerian production—on the heel's of Lagos's $5.50 per barrel cut—rebounded from about 450,000 b/d in mid-February to about 900,000 by the end of the month. Most other producers saw some further erosion in their oil sales, including Indonesia, Libya, and Iran who previously had been relatively successful in maintaining targeted production levels. 25X1

EC Coal Imports [a]

	Million Tons			1982 Percent Change
	1980	1981	1982	
Total	**74.4**	**70.5**	**70.0**	**−0.7**
France	22.6	20.1	17.0	−15.5
Italy	14.3	15.5	16.3	5.2
West Germany	7.3	8.1	8.6	6.5
Belgium	7.3	7.2	8.5	17.6
Denmark	9.1	8.7	7.6	−12.7
Netherlands	5.0	5.4	7.0	30.0
United Kingdom	7.2	4.1	3.6	−13.5
Ireland	0.9	0.8	0.6	−17.4
Greece	0.5	0.3	0.5	74.2
Luxembourg	0.2	0.2	0.2	11.6

[a] Excluding intra-EC trade.

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EC Coal Imports

According to preliminary data, EC coal imports last year totaled 70 million tons—less than 1 percent below the 1981 level and higher than most market analysts expected. Consumers continued receiving contracted volumes and purchased additional supplies at sharply reduced prices on the spot market despite lagging consumption. French, Danish, and United Kingdom coal purchases were down but were offset by increased imports by the Netherlands, Belgium, Italy, and West Germany. [redacted] 25X1

High stocks, combined with sluggish growth in consumption, probably will result in a sharper cutback in imports this year. In West Germany, stocks at mines alone are 35 percent above their 1981 level. As a result, German producers are pressuring electric utilities to back out of as much as 3.3 million tons of steam coal imports in 1983, most of which would come from the United States. In France, the state coal importing monopoly, ATIC, has informed the US Embassy that it probably will reduce coal imports from the United States from 8.5 million tons in 1982 to 4.5 million tons this year. [redacted] 25X1

OPEC: Crude Oil Production *Million b/d*

	1982	1983	
		January	February [a]
Total	**18.8**	**17.1**	**15.1**
Algeria	0.6	0.7	0.6
Ecuador	0.2	0.2	0.2
Gabon	0.2	0.2	0.2
Indonesia	1.3	1.2	1.0
Iran	2.3	2.8	2.6
Iraq	1.0	0.8	0.8
Kuwait	0.7	0.6	0.6
Libya	1.2	1.4	1.2
Neutral Zone	0.3	0.3	0.2
Nigeria	1.3	0.8	0.7
Qatar	0.3	0.3	0.2
Saudi Arabia	6.3	4.6	3.8
UAE	1.2	1.1	1.0
Venezuela	1.9	2.1	2.0

[a] Preliminary.

[redacted] 25X1

Italian Nuclear Power Program Moves Forward

Site qualification studies are under way for three 2,000-megawatt-electric (MWe) nuclear power stations to be located in Piedmont, Lombardy, and Puglia. The Italian nuclear power program had been at a standstill since 1978 when construction of the last nuclear power plant was begun. This recent progress is the result of new legislation providing financial benefits to regions and communities accepting such facilities and giving the Interministerial Committee for Economic Planning substantial authority over the siting of non-oil-fired electric generating plants. Financial incentives include a one-time payment of nearly $30 million to the community accepting the plant and annual payments of nearly $4 million to both the community and the region where the plant is sited. Despite these incentives, construction may be delayed due to continuing protests in the affected communities. [redacted] 25X1

Declining Belgian Industrial Electricity Prices

Following the startup in Belgium of two new nuclear power plants over the past four months and the resulting decrease in dependence on more expensive oil-fired electricity generation, the Belgian Supervisory Committee for Electricity and Gas has recommended that industrial electricity prices be cut. These rate reductions, if approved, would further increase Belgian industry's price competitiveness relative to other West European countries. From 1977 to 1982, Belgian industrial electricity prices dropped from the highest in Western Europe to the second lowest after France. Nuclear-generated electricity probably will account for about 50 percent of Belgian electricity generation in 1983, compared with about 30 percent in 1982. [redacted] 25X1

International Trade, Technology, and Finance

Soviet-US-Argentine Grain-Trade Activity

[redacted] Moscow will not buy more US grain until arrangements are made to discuss renewal of the Long-Term Grain Agreement, which expires 30 September. They also have said the US commitment to honor grain contracts is not adequate but ought to apply to contracts for Soviet purchases of machinery and equipment as well. Soviet officials visiting Argentina say they do not plan to buy more Argentine grain now. [redacted] 25X1

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The Soviets have not purchased grain from the United States since mid-December and are anxious to get grain-trade discussions under way. Moscow's failure to buy more US grain in February will limit total grain imports for the marketing year ending 30 June to 37 million tons at most. The USSR may hope that not buying at a time when the United States has to contend with record grain stocks and an estimated 12-percent drop in grain exports this year will persuade the United States to negotiate. The Soviets may reenter the Argentine market later this month, particularly if they do not buy from the United States, to ensure a steady flow of coarse grains from April through June. The USSR may have stopped buying Argentine grain to demonstrate its concern over the large trade imbalance with Argentina. [redacted] 25X1

The US commitment to honor grain contracts has encouraged the Soviets, and they would like to have the commitment extended to industrial products they particularly need from the United States. This suggests Moscow continues to view the United States as a long-term trading partner, even though it currently is trying to play down the importance of trade with the United States. [redacted] 25X1
[redacted] 25X1

EC Interest in Rescheduling Polish Debt

EC countries are increasingly anxious to begin talks aimed at rescheduling Poland's $10 billion in debt backed by Western government guarantees. Last week EC Foreign Ministers agreed to discuss with the United States and other creditors the need to reschedule overdue payments for $4 billion owed by Warsaw in 1982. Western governments suspended rescheduling negotiations with Poland in response to martial law, and since December 1981 Poland has refused to make any installment or service payments on officially backed debts. West German Foreign Minister Genscher, who chaired the meeting, contended that the stalemate benefits only Poland because Warsaw makes no payments. The Community wants to bring the issue before the Paris Club—the group of major Western governments responsible for rescheduling officially backed debts—when it meets next month. EC Foreign Ministers want the Club to agree to negotiate simultaneously with Poland on the payment of arrears on the debt rescheduling agreement for 1981 and on ways to reschedule the debt for 1982.
[redacted] 25X1

The Foreign Ministers apparently have concluded that refusing to reschedule Warsaw's debt has had little influence on political developments in Poland. West Germany and France, in particular, previously believed that agreement to reschedule would send the wrong political signal to Polish authorities and weaken Western unity. Community members now agree that this policy created a de facto moratorium on debt repayment that inadvertently rewarded Warsaw and is increasingly difficult to justify to national parliaments. The EC countries probably will increase their informal efforts before the next meeting of the Club to secure US agreement to resume debt rescheduling talks with Poland. EC leaders probably will discuss developments in Poland and debt rescheduling at their summit meeting in Brussels on 21 and 22 March. [redacted] 25X1

Cuban Debt Rescheduled

Western creditors reached a debt rescheduling agreement with Cuba last week, according to the US Embassy in Paris. Ninety-five percent of Cuba's medium- and long-term principal due from September 1982 to December 1983 was rescheduled for eight years, including a three-year grace period. The creditors established performance targets for trade and current account balances, growth rates, debt and reserve levels, and a monitoring system to review Cuba's performance. Provisions for rescheduling principal due in 1984 were linked to Havana's compliance with the targets. [redacted] 25X1

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The agreement's terms were slightly stricter than other recent debt reschedulings, and the Cubans will be hard pressed to meet some of the targets. They particularly will have trouble achieving a positive current account balance and an economic growth rate of 2 to 2.5 percent. The current account balance at the end of 1983 probably will be negative, and growth for this year is likely to be less than 1 percent. Havana thus may find negotiations for rescheduling principal due in 1984 to be more difficult. 25X1

Jamaica Bickering With IMF

Prime Minister Seaga and the IMF are embroiled in tough negotiations over the third year of the 1981 stabilization program due to start in April. The IMF insists that the budget deficit in 1983/84 be trimmed to under 15 percent of GDP in response to falling bauxite receipts and anticipated reductions in foreign assistance, but Seaga is resisting further budget cuts that would boost unemployment and chip away political support. Because Jamaica is unlikely to meet the IMF's net foreign reserve target later this month, any waiver request probably will result in an even stricter program that would include deeper expenditure cuts. 25X1

Additional EC Grain Sale to China

The EC has sold China 500,000 tons of French wheat and also is offering 300,000 tons of flour. The Community sold the Chinese 875,000 tons of grain last summer—well above its average annual shipment of 500,000 tons—and would like Beijing to buy another 600,000 tons this fall. Traders in EC wheat began offering flour to China in December, and any sales probably will be subsidized. China's increased purchases of French and Argentine wheat probably will contribute to a 1-million-ton decline in US grain exports to Beijing this year. 25X1

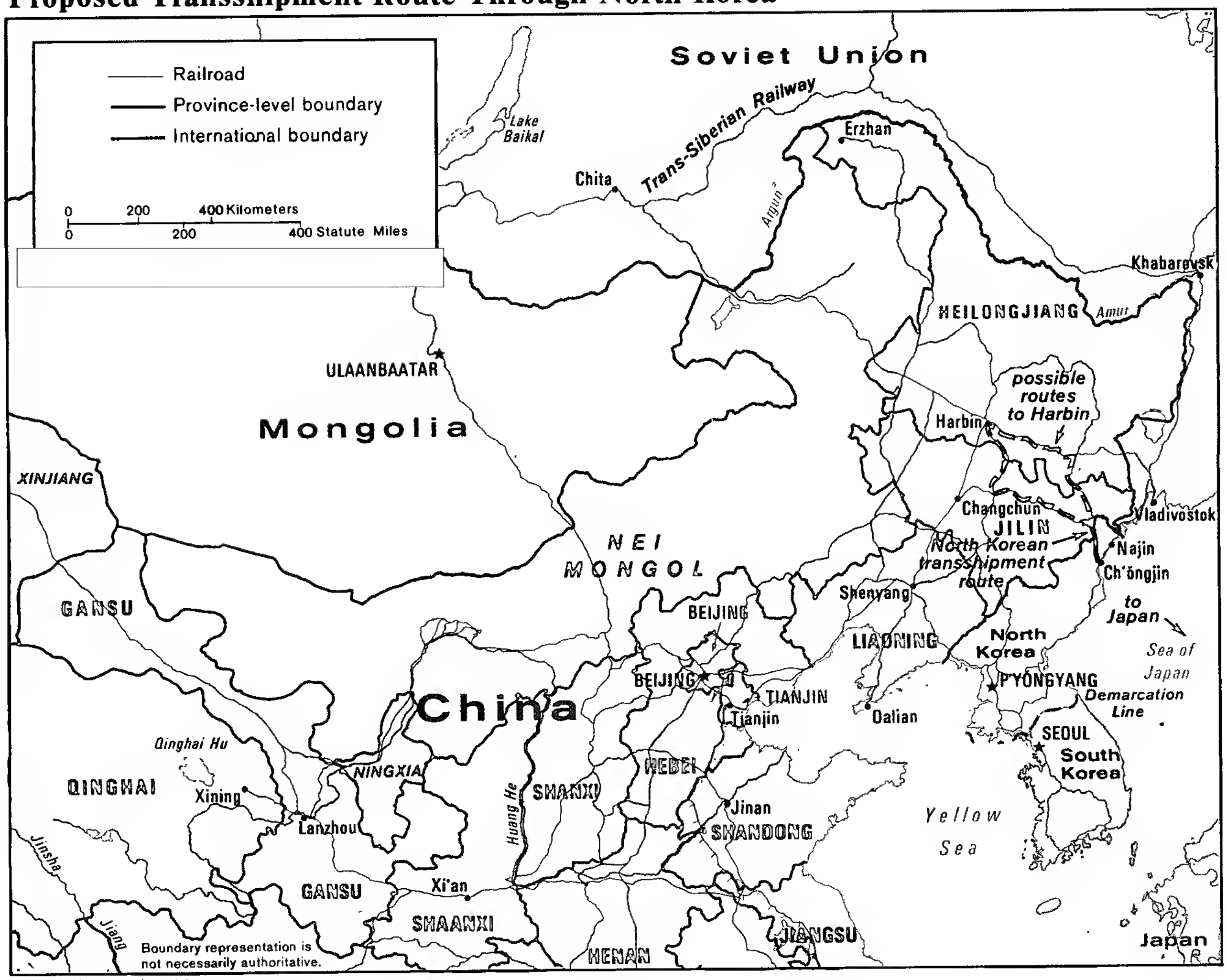
China Ordering US Commercial Aircraft

A Chinese delegation of airline and aircraft industry officials reportedly has come to the United States to purchase five DC-9 McDonnell Douglas commercial aircraft, possibly for delivery as early as this spring. The Chinese had delayed purchasing additional Western aircraft because of disagreements between airline officials, who only wanted Boeing aircraft, and aircraft industry representatives, who sought the DC-9 manufacturing process to develop their industry. Late last year CAAC—China's airline—received State Council approval to purchase 12 Boeing commercial aircraft with the understanding that the aircraft industry would continue negotiations for DC-9s. The industry already makes DC-9 landing gear doors at its Shanghai plant and reportedly wants to negotiate the next phase of a production agreement with McDonnell Douglas. Shen Tu, director general of CAAC and new member of the Communist Party's Central Committee, recently hinted that those US firms that offer high-technology production contracts are more likely to receive sales contracts. Although the DC-9 does not represent state-of-the-art technology, its manufacturing process will be less difficult to obtain and, at the same time, the aircraft can be used effectively to meet China's domestic needs. 25X1

Japanese–Chinese–North Korean Transshipment Agreement

China and North Korea reportedly signed a 10-year agreement last December giving China access to North Korea's Ch'ongjin port. The agreement, concluded in close coordination with Japanese shipping interests, calls for the use of a rail route—last used by the Japanese in 1945 when they controlled the entire area—that extends some 750 kilometers from Harbin, China, to Ch'ongjin. Japanese shippers will use the route, which is expected to handle up to 300,000 tons annually for the first few years, to export agricultural machinery and equipment to northeast China and to import agricultural products—primarily soybeans. 25X1

Proposed Transshipment Route Through North Korea



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Japanese, Chinese, and North Korean interests have been negotiating this transshipment agreement since early 1981. The new route will ease pressure on China's port of Dalian and reduce transport costs. North Korea expects additional foreign currency earnings and assistance in expanding its largest and busiest east coast port. China reportedly has already promised to supply Ch'ongjin with new cranes. Moreover, China's use of Ch'ongjin would balance the Soviet Union's almost exclusive use of Najin port. Japan believes the route—in addition to facilitating Sino-Japanese trade—could provide another overland link with the Trans-Siberian Railway to carry container traffic to the Middle East and Western Europe. Early last year, China and the Soviet Union amended their transport agreement to cover containerized shipments and to permit the Soviet Union to ship goods through northeast China to North Korea. [redacted] 25X1

Possible Toyota Investment in Iran

[redacted] 25X1 the possibility of Toyota establishing automobile production facilities in Iran, [redacted] 25X1 [redacted] such an agreement would depend on Toyota's willingness to 25X1 transfer production technology to Iran, indicating that they would not be satisifed with just an assembly operation, which has been characteristic of Toyota's investment in the Middle East. The Japanese auto industry is actively pursuing Third World markets in the face of declining exports sales in the industrialized West. With Iran the eighth-largest auto market outside Western Europe and North America—based on 1980 passenger car registations—we believe other Japanese automakers will seek similar discussions with Iran. [redacted] 25X1 [redacted]

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National Developments

Developed Countries

Australia Devalues Currency

In one of his first moves since being elected on 5 March, Prime Minister Hawke announced a 10-percent devaluation of the Australian dollar against a trade-weighted basket of currencies. The move is intended to end currency

speculation and slow capital outflows. Despite Hawke's repeated denials of a devaluation during the campaign, the financial community expected one and moved over $2 billion out of Australia after Fraser called elections in early February. Although the devaluation will slow capital outflows and imports, it will also add upward pressure to inflation, which was 11 percent in 1982. In response to the devaluation, New Zealand and Papua New Guinea, which both trade heavily with Australia, devalued their currencies by 6 percent and 5.5 percent, respectively. 25X1

South Africa Struggling To Control Budget

The Finance Minister has requested nearly $750 million in supplemental appropriations to cover higher-than-budgeted government spending—especially for defense—until the end of the current fiscal year on 31 March. Nevertheless, Pretoria has been able to contain the deficit—now likely to be less than 3 percent of GDP—without recourse to inflationary bank borrowing because an unexpectedly strong recovery in the price of gold in second-half 1982 has generated additional tax receipts. With the new appropriations, total spending for the year will have risen by 16.4 percent instead of the 11.5 percent budgeted in March 1982. 25X1

Difficulty in controlling spending probably will continue. Pretoria has given top priority to reducing the country's 14-percent rate of inflation and plans to present an austere budget later this month for fiscal 1983/84. There is little room, however, for spending cuts in the recession-plagued and drought-stricken economy. The drought—which will sharply reduce South Africa's corn exports this year—is creating demands for agricultural relief spending. Meanwhile, the IMF has told Pretoria that education and training should not bear the brunt of spending cuts needed to meet the terms of balance-of-payments assistance extended to South Africa last year. In addition, the phasing out at IMF request of an import surcharge is eliminating an important source of receipts. Recent remarks by the Finance Minister suggest that the sales tax—raised twice last year—will not be reduced for the time being. Gold will continue to be a crucial but unpredictable source of government revenue and a key factor in containing the deficit. 25X1

Spanish Foreign Banking Regulations Tightened

To slow the growth of foreign banking activities, the Bank of Spain has sharply raised the amount of startup capital required for a bank to open a branch in Spain. Further disincentives, such as demanding that a foreign bank place half the required startup capital in a noninterest bearing account upon application for a branch, also are being considered. The decision ends an effort dating from 1978 to promote the establishment of foreign bank branches. Government officials believe the original goal of stimulating competition in the banking sector already has been achieved, and the Socialists are hoping to appease domestic bankers, who resent the profitability of US banks operating in Spain. Bank representatives in Madrid disclosed to Embassy officials that the new policy prompted Wells Fargo to withdraw its application for a branch and influenced First National Bank of Boston's decision to close its representative office. 25X1

Austrian Trade Deficit With East Reduced

Austria's trade deficit with CEMA's European member countries declined markedly last year, dropping from a record $760 million in 1981 to $434 million for 1982. Although exports increased only marginally despite vigorous export promotion efforts, declining prices for energy products—which account for 60 percent of Austrian imports from the East—greatly reduced the cost of imports. Austria substantially improved its terms of trade with CEMA—import prices for CEMA goods declined 0.2 percent while Austrian export prices rose 5.2 percent—a trend that probably will continue this year. Sharply increased sales to Czechoslovakia and the USSR more than offset the decline in Austria's exports to Poland and Romania. Austria probably will continue to push export sales to CEMA to reduce unemployment that is especially high in those sectors most dependent on Eastern markets. 25X1

Less Developed Countries

Large Commercial Credit for Mexico

Mexico City has partially deflected the bad news of falling oil export revenues by announcing syndication of a $5 billion commercial credit for 1983 that had been under negotiation since December. Because the first disbursement will not be available immediately, Mexico's bank advisory group arranged a $434 million bridge loan. The three later installments of the $5 billion credit will be contingent on Mexico's meeting the quarterly targets for its IMF stabilization program. 25X1

Falling oil revenues, triple-digit inflation, and the steep decline in economic activity, nevertheless, have sparked devaluation rumors and renewed capital flight. As a result, a large market for discounted pesos has pushed the peso to 160 to 170 to the dollar. Meanwhile, the "free" market rate in Mexico City remains at 150 to the dollar, and the controlled rate currently stands at 105 to the dollar. [redacted] 25X1

Added Budget Problems for Mexico

Higher imports of corn this year—largely under US Government credit—are helping relieve critical shortages, but highly subsidized sales to consumers are aggravating already serious budget overruns. Poor weather and inflexible government pricing policies reduced Mexico's 1982 corn output by 40 percent to 7.5 million tons. The US Department of Agriculture now estimates that Mexico will have to import 5 million tons of corn this year compared with just 0.6 million tons last year. [redacted] 25X1

After paying $110 per ton for imported corn, Mexico City resells it to bakers for $40; this practice will cost the government approximately $350 million this year. Despite the subsidized prices, tortilla makers went on strike last month demanding relief from price controls because of rising costs. At the same time, politically powerful labor unions are demanding that the price freeze on basic foods be continued. The government is caught between trying to satisfy IMF requirements while preserving political support. Because President de la Madrid cannot afford to alienate labor, government expenditures are likely to rise to cover the cost of imports, driving the budget even further into deficit. [redacted] 25X1
[redacted] 25X1

Argentine IMF Program Under Fire

Argentina's IMF program is drawing increasing domestic criticism as more becomes known about its tough economic conditions. According to the US Embassy, most Argentine political groups—including some members of the military junta—are stepping up attacks on the government's determination to impose fiscal austerity, tighten credit, and increase prices for public services and petroleum products. Because of growing internal resistance, the economic team thus far has been unable to agree on the public spending cutbacks necessary to comply with IMF-mandated budget reductions. In addition, the business sector is criticizing Central Bank President Gonzalez for raising interest rates even though the IMF program commits Buenos Aires to adjust lending rates in line with inflation. [redacted] 25X1

The Embassy reports the Argentine economic team is not meeting IMF targets for increasing real public-sector prices. Gasoline prices increased only 13 percent in February and pressures from the business sector prevented any rise in diesel and fuel oil prices. There also is increasing popular pressure to postpone or hold down public-sector price increases in an effort to restrain

inflation in March. Buenos Aires now is promising to resort to price controls, mainly for food essentials, in an attempt to calm public furor over inflation—prices were up 16 percent in January and about 12 percent last month. These short-term politically motivated policies, however, probably will increase the government deficit and further undermine the IMF program. 25X1

Honduran Debt Rescheduling Nears

The Honduran Government's recent preliminary agreement to reschedule $120 million in commercial debt represents a step forward in clearing up the borrowing excesses by the former military regime. The seven-year accord covers over 10 percent of the country's external debt with terms that include interest set at 2.25 percentage points over LIBOR and the postponement of almost all principal payments until the late 1980s. The final agreement, expected to be signed on 24 March, is conditioned upon prompt interest payments on the rescheduled debt and compliance with IMF standby targets. The latter stipulation is proving hard to keep; Honduras already has jeopardized an early 1983 standby disbursement by overexpanding public credit to pay overdue interest on the soon-to-be rescheduled debt. The US Embassy believes that a finding of noncompliance at this time would complicate the rescheduling process but not necessarily abort it. 25X1

Pakistan's Creditworthiness Shaky

Pakistan, a strong candidate for debt rescheduling this year, probably will have difficulty syndicating a planned $225 million medium-term Eurocurrency loan. The country's debt-service ratio—excluding workers' remittances and new debt relief—probably will exceed 40 percent in 1983, and large current account deficits are projected for several years. Western lenders are unhappy with the way Islamabad is managing some key areas of the economy, and bankers claim that the country's heavy reliance on workers' remittances to deal with balance-of-payment deficits is unrealistic and shortsighted. 25X1

Iraqi Attack on Iranian Oilfield

Iraqi aircraft last week bombed Iran's Nawruz oilfield, which is near the head of the Persian Gulf. Two platforms serving six wells reportedly were destroyed. The field at Nawruz and two associated fields probably had been producing less than 20,000 b/d. Iran still has more than 3 million b/d of production capacity. This attack, however, could lead to an increase in the air war. In the past the Iranians have retaliated for successful attacks on their facilities by attacking economic targets in Iraq. 25X1

Possible Increase in Iranian Emigration

Almost 500,000 Iranians have applied for exit permits since Tehran relaxed travel restrictions and currency exchange regulations early last month, Foreign Ministry officials estimate that as many as 7 million may apply, and many who leave will not return. The regime hopes that the new regulations and the domestic liberalization campaign ordered by 25X1

Ayatollah Khomeini in December will win over Iranian professionals and persuade them to participate in rebuilding the economy. It is unlikely to allow many skilled Iranians to leave, however, and multiple security checks and bureaucratic inefficiency will delay any exodus for several months. Tehran evidently is willing to accept the permanent loss of citizens who are disgruntled with the revolution to reduce discontent. [redacted] 25X1

Communist

China Planning To Increase Exports of Nonferrous Metals

The Ministry of Foreign Economic Relations and Trade reportedly has called for an increase in nonferrous metals exports to help boost foreign exchange earnings. Current annual exports of nonferrous metals and ores total about $500 million and have been growing at close to 50 percent annually since 1979. Chinese exports of tungsten and lithium, which have grown despite depressed world demand, probably will accelerate under the new policy. China probably also will seek to sell titanium to the United States for its expanding strategic stockpile [redacted] 25X1

China already has demonstrated its ability to become a major force in international markets for new metals; when China began exporting vanadium in 1980, it undercut world market prices by 20 percent, thereby becoming the world's third-largest exporter of vanadium. It has followed a similar strategy with molybdenum and tantalum. China has large exploitable reserves of other nonferrous metals and could readily purchase the equipment necessary to expand production. [redacted] 25X1

An Oil Price Drop: Opportunities for the United States

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A sharp drop in oil prices would spark far-reaching changes in the international economic and political order. What this would mean in terms of US influence is difficult to assess, but the nature of US strategic concerns would shift, perhaps substantially in some parts of the world. For one thing, those countries dependent on oil sales for their well-being would see their economic and political power sharply eroded; some could experience internal unrest. In turn, nations that rely heavily on financial flows from the oil-producing states—whether in the form of aid, export earnings, or worker remittances—would likewise see their economic situation deteriorate. Countries that are net oil importers will benefit, but for many their economic and political problems are so deep seated that even a substantial cut in oil import costs would do little to brighten the outlook.

In a more general sense, lower oil prices—by lowering inflation, reducing interest rates, and spurring economic growth—will strengthen the US economy and therefore the US Government's flexibility in pursuing foreign policy initiatives. The overall stress on the international financial system should ease, lightening the burden the United States carries as the primary lender of last resort. While financial strain will increase in major oil producing LDCs, this need not, if carefully managed, negate the benefits of lower oil prices for the oil importers. In the same vein, lower oil prices in time should lead to an expansion in world trade, which will contribute to more rapid economic growth. US business would then be in a better position to seek out trade and investment opportunities, particularly in Third World economies that are constrained by high oil import bills and debt.

A major benefit accruing to the United States from a sharp drop in oil prices would be the prospect of greatly reduced hard currency earnings for the Soviet Union. As it is, the Soviets earn over half of their total hard currency from sales of oil and gas; they earn on average another 5 to 10 percent from gold, the price of which has plummeted recently. As these earnings shrink, the USSR will have to choose more carefully those countries or groups it wishes to support, and Moscow would likely offer less generous terms for aid and military sales. In addition, Soviet surrogates like Cuba could face reduced levels of support that could act as a constraint on their activities. At a minimum, however, the relative change in US/Soviet economic strength could have an important psychological impact on developing nations. For one thing, a forced Soviet retrenchment would lessen the allure of the Soviet model. For another, a relative rise in US economic power would likely assure Washington greater access as a variety of countries look to the United States for assistance in getting back on the growth track.

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Africa

We believe lower oil prices will create problems for the USSR and that, as a result, new opportunities may open up for the United States in Africa. While we do not anticipate that the Soviets will pull up stakes anywhere, a reduced Soviet presence could make some governments more amenable to US overtures or lead to requests for US military or economic assistance. At the same time, however, any oil-related instability could provide Moscow and its surrogates with opportunities for meddling that might not otherwise occur:

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- The export of ***weapons*** is the most important instrument of Soviet policy in the Third World,

and the USSR sets lower interest rates and longer repayment periods for arms sales than Western suppliers. Now, however, we have reports that in two cases this year—Tanzania and Zambia—the Soviets have suspended or threatened to suspend arms deliveries until the buyers make payments. The declining price of oil may be contributing to Moscow's tougher stance.

- Moscow's traditional unwillingness to provide large amounts of economic aid to the Third World has been a handicap in trying to win influence, particularly in impoverished African states. Offsetting this handicap through military aid may now be more difficult. Should opportunities for Western economic assistance or political support arise, France could be urged to strengthen its role. Paris has already stepped in to check developments that threatened to advance Soviet interests in Zaire, Chad, and portions of West Africa.

- We believe some of the greatest prospects for Soviet losses in Africa over the next several years will be in ***Namibia***, ***Angola***, and ***Mozambique***.

- If Soviet and/or Cuban support has to be cut back, Moscow could see its influence being undermined in these countries.

- In the ***Horn of Africa***, we believe that Ethiopia and its Soviet, Libyan, and Cuban backers will still attempt to undermine support for US military access agreements in the area and try to weaken or overturn the governments of Somalia and Sudan. These efforts may be hampered, however, if the Soviets are forced to reduce their commitment.

The Soviet angle aside, we believe that by far the largest and most direct impact of lower oil prices on US interests in Africa will come in Nigeria. In our judgment, President Shagari will increasingly look to the United States for financial assistance. In most other African countries, lower oil prices will reduce financial strains, but only slightly. They will have to await an upturn in OECD demand for their nonfuel commodities before any marked economic improvement occurs. Partly because of the sad state of their economies, there may be opportunities in several West African countries for the United States to influence the direction their governments take in dealing with the USSR.

- ***Nigeria*** is heading toward its most serious economic crisis since the 1967-70 civil war. We believe President Shagari will be forced to continue or strengthen austerity measures despite the pressures of a general election campaign in mid-1983. In our judgment, sudden additional retrenchment could spark widespread disorder and encourage sentiment for a coup within the military. If dissatisfaction grows during the runup to elections, Shagari may seek increased sales of Nigerian oil for the US Strategic Petroleum Reserve, a food-for-oil barter agreement, or a substantial emergency loan similar to that arranged with Mexico.

- ***Ghana's*** economy continues to deteriorate, and the few policies articulated by the Rawlings regime are unlikely to have much positive impact because they fail to address underlying structural problems. In our view, radicals in Rawlings's entourage are consolidating their power and will try to align Ghana more closely with Communist states and Libya.

- ***Guinea's*** President Sekou Toure, long one of Africa's most vociferous radicals and strongest supporters of Moscow, has been expressing growing frustration with the Soviet Union and establishing closer ties with the United States and other Western governments. He has also become a vigorous spokesman for moderate West African states concerned about Libyan interference in regional affairs. Moscow's failure to provide adequate economic help has contributed to Toure's strong dissatisfaction with the Soviets, a feeling that could be reinforced if Moscow has to trim its aid.

- Of the two principal emerging oil producers in Africa—***Cameroon*** and the ***Ivory Coast***—we believe Cameroon stands the best chance of handling a decline in oil prices, largely because it has a strong agricultural sector. Moreover, in our judgment, Cameroon has been more successful than Nigeria or Gabon in handling its oil windfall. As the sole buyer of Cameroon's oil, the United States may need to do little more than demonstrate concern to ensure a continuation of President Biya's strong pro-Western stance. The situation in the Ivory Coast, still a net oil importer, is more tenuous. To the extent that revenues from the emerging petroleum sector are reduced, the risk of a military government replacing aging President Houphouet-Boigny will increase.

Latin America

We doubt that a sharp drop in oil prices would substantially alter US relationships with most Latin American countries. In Mexico, Venezuela, and Brazil the US Government and/or US banks already play a dominant role in their financial affairs. In these countries the challenge may be to avoid the appearance of dictating policy. Argentina, which is self-sufficient in oil, is preoccupied with arranging the transition from military to civilian rule and with carrying out its economic stabilization program. We see little likelihood of lower oil prices doing anything to change this inward focus.

- The new ***Mexican*** Government will have a hard time imposing the austerity needed to bring financial order without disrupting the internal political balance. A large oil price decline would place President de la Madrid in a desperate position. He would probably have to weigh the pros and cons of debt repudiation, which would sharply lower US bank profits and cause some to fail. To maintain US financial backing, de la Madrid will seek to keep US-Mexican relations on an even keel, but we think some grating episodes are inevitable. While he has told US officials that he intends to avoid inflammatory public statements, he has publicly stated he will maintain close ties with Havana and Managua. Given the large role the United States would have to play in Mexico's economy, Washington might gain some quid pro quos on foreign policy—particularly on Central American and North-South issues.

- ***Venezuela*** would be unable to pursue its domestic economic development program and would have to cut sensitive social programs in the event of a sharp oil price decline. In this election year, however, President Herrera's austerity program will be at risk from strong party pressures for pork barrel spending. Even if tougher adjustments are undertaken, we think there is a better than even chance that Venezuela will experience a foreign exchange crisis by mid-1983. As Venezuelan leaders struggle with economic problems, they will look to the United States for support. Mindful of the role that US firms and lending institutions can play, Venezuela could well be persuaded to mute its frequent posturing as a self-appointed spokesman for the Third World on North-South issues. Domestic constraints will limit Caracas' involvement in regional affairs; the joint Venezuelan/Mexican oil financing facility and regional aid programs will be sharply curtailed.

- ***Brazil*** would be the largest LDC gainer from a decline in oil prices, but the drop would have to be substantial to reduce pressures on the current account. Continued US support is essential to avoid Brazil's declaring a moratorium on debt repayments. If this were to occur, we believe the economy would go into a tailspin. Rising unemployment, real wage declines, and mounting business failures would trigger social unrest. Anything Brazil might do in return for US help might not be worth the consequences of withholding US support.

- The suspension of Dutch aid following the December execution of 15 leading critics of ***Suriname's*** Government is raising the prospects for increased Cuban involvement. Bouterse has already warned publicly that he will seek aid from the Soviet Bloc if Western countries do not come through. After a military coup almost succeeded in March 1982, Bouterse turned to Havana for political support. We believe, however, that Cuba cannot afford to be very generous.

- The ***Central American*** and ***Caribbean*** countries are highly vulnerable to the negative feedback effects of an oil price drop. Growth has already slowed sharply, and increased borrowing to help finance worsening current account deficits pushed the region's medium- and long-term external debt to $15 billion at the end of 1981. If the oil price decline impairs bank lending to the region, the impact on their fragile economic and political systems would be serious. The region also stands to lose the aid it has received from Venezuela, Mexico, and Trinidad and Tobago. The United States could score sizable political gains for relatively small sums of money by offsetting some of the lost aid. [redacted]

South and Southeast Asia

Among the South and Southeast Asian LDCs of strategic interest to the United States, we think lower oil prices pose the greatest threat to Indonesia and Pakistan. An economically weakened Indonesia would provide fertile ground for troublemaking by Islamic fundamentalists or other dissident groups. This could force the Soeharto government to focus on domestic politics to the detriment, for example, of ASEAN efforts to achieve a political settlement in Indochina. Pakistan, although an oil importer, would be hard pressed financially if Saudi aid and remittances from Pakistani citizens working in the Persian Gulf states were substantially reduced. In India, Prime Minister Gandhi apparently is trying to steer a more neutral course between the United States and the USSR than she has in the past; any US move to increase military aid to Pakistan might jeopardize the recent thaw in US-Indian relations. As for South Korea and the Philippines, we would anticipate no significant changes in their relations with the United States as a consequence of lower oil prices:

- ***Indonesia*** would have to cut development spending drastically. We estimate Indonesia will run an $8-11 billion current account deficit this year. In return for US help in arranging financing for the deficit, Jakarta might be persuaded to abandon plans to further restrict the operating environment for foreign oil companies.

- Foreign exchange losses associated with any Saudi retrenchment could result in intense pressures on ***Pakistan***. From General Zia's perspective, the economic and political balance would be shifted in favor of India, which would see its oil import bill fall sharply. Growing economic and political presures are unlikely to affect the nuclear program since Zia views it as a mechanism to maintain regional balance.

Middle East 25X1

The Middle East would bear the brunt of an oil price drop. Although the Gulf Arabs' huge reserve holdings would cushion the impact, lower revenues could constrain their ability to support the Iraqi war effort. The prospect of an Iranian victory could prompt the Saudis to quietly seek closer ties with the United States. US interests in Iran and Libya would be little served by lower oil prices. With tighter government political and economic control, both have relatively greater flexibility in dealing with a price decline, and both have already reduced imports. Under certain circumstances, a drop in oil prices could lead Syria to act in ways which coincide with US objectives. Syria receives substantial aid from Iran, the USSR, and the Gulf States. If financial pressures forced a cut in these flows, Assad would probably realign himself with the Saudis and possibly lessen his support for Iran:

- Despite ***Syria's*** reliance on outside financial support, Assad has not been willing to temper his

foreign policy to suit the tastes of his more conservative Arab backers. If both Iran and the Gulf states cut their economic support due to their own cash flow problems, Assad would probably view the Gulf states as more dependable and easier marks over the long haul. We expect he would reingratiate himself with the Saudis by backing away from his support for Iran, and possibly accede to Saudi pressure to withdraw troops from Lebanon or support a Jordanian-PLO dialogue. US attempts to influence this course of events could well prove self-defeating.

- ***Saudi Arabia's*** sense of vulnerability to Iranian and Libyan threats would rise if oil prices fell sharply. Riyadh's limited ability to influence the PLO and the Arab confrontation states through its aid program would also be eroded if aid had to be curtailed. Under these circumstances, the Saudis would be less willing to press Arab radicals like Syria to adopt more moderate positions on important regional issues. The Saudis might also feel compelled to publicly distance themselves from the United States on a broad range of political issues while realizing privately that the United States remains the ultimate guarantor of Saudi security.

- ***Iran's*** political-economic strategy will be little affected by an oil price drop. Imports remain low because of the limited development objectives of the Khomeini government. Indeed, Iran is able to get along on far less oil revenues than it presently receives—additions to reserves in 1982 totaled some $2 billion. Moreover, the regime could probably cut domestic spending further without any serious impact on internal stability. Iran's basic hostility toward the United States and its suspicion of Soviet motives will remain regardless of what happens to oil prices.

- ***Iraq*** could face more problems from an oil price drop than any other Gulf oil producer. Not only would its own oil revenues fall, but the massive aid from other Gulf Arabs on which Iraq survives would be put at risk. Nonetheless, we believe that an oil price drop would not significantly alter Iraq-US relations. The United States imports virtually no oil from Iraq, and US exports are small. Although Iraq may seek additional CCC credits—these totaled $210 million last year—agricultural credits provide the United States with little leverage.

- Iraq may be a country where the Soviets have decided to target their shrinking aid resources. We believe this results in part from the Soviets' frustrations over their deteriorating relations with Iran. Moscow also wants to ensure an arms market in Baghdad when the war ends and to reverse Iraq's increased reliance on Western military suppliers.

- ***Libya*** would see its export earnings plunge as a result of a sharp decline in oil prices, but we see little likelihood that this would change Qadhafi's behavior. Libya's current account was almost in balance last year, and Libya's support for terrorism and military adventures probably has never cost more than $200 million in any year since 1978.

- ***Egyptian*** oil revenue losses would make US economic and military assistance increasingly important. Alternatives to US assistance will be less likely as oil prices decline. The Persian Gulf states and the USSR will have other aid recipients that they may deem more important. Thus, even if Egypt overcame the political barriers to renewed aid relationships with these countries, they would not be in a good position to provide much assistance.

- Although ***Sudan's*** current account deficit will benefit from falling oil prices, Khartoum will still look to the United States for guidance in dealing with the IMF and with official and private creditors. If lower oil prices lead to a reduction in aid from Arab oil producing states, Khartoum will doubtless seek additional US assistance.

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European Community: Protectionist Trends 25X1

Double-digit unemployment and growing import competition in both declining traditional industries and developing high-technology industries are prompting the EC to increase protectionist measures. The Community is relying primarily on export restraint agreements to limit imports. In addition, the Community appears to be making increasing use of antidumping and countervailing duties. With real economic growth likely to remain sluggish in 1983 and the unemployment rate expected to reach 12 percent later this year, protectionist pressures will continue to mount

The EC has concentrated its protective efforts against Japan and the newly industrialized countries. Little pressure exists to add new restrictions on US industrial access to the Community because the dollar's appreciation has reduced the competitiveness of US products. Nevertheless, pressure for limiting imports of US agricultural goods is certain to grow if the United States continues to sell subsidized agricultural commodities to third-country markets that the EC considers its traditional domain.

EC Trade Policy

In general, the EC has been an advocate of free trade. In previous multilateral trade negotiations the EC agreed to reduce its Common Customs Tariff (CCT) by 7 percent in the Dillon Round (1960-62) and by another 37.5 percent in the Kennedy Round (1964-67). When the cuts agreed to during the Tokyo Round (1973-79) are fully implemented in 1987, the average duty of the Community will drop to about 5 percent compared to approximately 3 percent for Japan and 6 percent for the United States. In addition, the EC introduced the generalized system of preferences (GSP) in 1971—the first major trading power to do so. In 1977 it signed an industrial free-trade accord with the six members of the European Free Trade Association (EFTA), thus eliminating tariffs on domestically produced industrial goods within most of Western Europe. With the conclusion of the 1975 Lome Convention, the EC agreed to grant duty-free access to most industrial exports from 63 African, Caribbean, and Pacific countries and during the 1970s concluded preferential trade agreements with most countries bordering the Mediterranean. 25X1

The EC has promoted trade liberalization efforts 25X1 because trade is the life blood of the Community. As the world's largest trading block, the EC accounts for more than one-third of world exports, considerably more than the United States and Japan put together. Exports amount to an average 25 percent of member states' GDP compared with only 8 percent for the United States and 12 percent for Japan. Manufactured goods account for nearly 80 percent of the Community's total exports and almost 45 percent of the world's exports of manufactured goods. 25X1 Over half of member states' trade is with one another while about 20 percent is with EFTA countries. 25X1

Despite its general free-trade orientation, the Community has protected certain domestic industries. For example, the EC's Common Agricultural Policy (CAP) with its variable import levy system has been a major barrier to foreign agricultural goods. While the average CCT level may be relatively low, the EC maintains relatively high tariff rates on many "sensitive" products such as semiconductors (17 percent) and automobiles (10 percent). 25X1

European Community: The Players in Trade Policy Development

The development of EC trade policy is a complex process that involves the interaction of member country representatives among themselves as well as with the Community's own bureaucracy. This entire process takes place at various levels and may even include meetings of the EC heads of government. 25X1

The Commission *serves as the executive arm of the Community. It is composed of EC civil servants who, at least in theory, are working for the best interests of the Community as a whole, not their national governments. The Commission initiates policy proposals and carries out agreed EC policies. At international meetings it acts as the official EC spokesman and negotiates on behalf of the Ten.* 25X1

The Council of Ministers *is the primary decisionmaking organ of the EC; it approves Commission proposals, as well as proposals of its own, usually by consensus. It is composed of ministerial level representatives of the national governments.* 25X1

The 113 Committee*—named after Article 113 of the Treaty of Rome—acts as the go-between for the Council and the Commission. It is composed of member country representatives and helps interpret Council decisions so that the Commission can accurately implement EC policies. The Committee assists the Commission in negotiations on trade and tariff matters with third countries.* 25X1

The EC and its individual members also have utilized nontariff barriers (NTBs) to restrict imports. At the Community level, the Multifiber Arrangement (MFA), originally formulated in 1973 with GATT approval, has been increasingly relied upon to protect the Community's textile industry. In 1978 the EC negotiated voluntary export restraint agreements (VERs) with 15 of its principal steel suppliers. 25X1

Since 1955 Italy has limited imports of Japanese automobiles to 2,200 vehicles per year, and successive French governments have unilaterally limited the Japanese share of the French automobile market to no more than 3 percent. British manufacturers have negotiated "prudent market agreements" with their Japanese counterparts since 1975; the auto agreement limits Japan to no more than 11 percent of the British market. 25X1

Mounting Protectionist Pressure

With EC industrial production down 3.7 percent in 1982 compared to 1980 and the unemployment rate now over 10 percent, the EC Commission is under increasing pressure from industry and member governments to further limit foreign access to EC markets. The hardest hit industries—steel, textiles, and automobiles—are crying the loudest. Last year, employment in the steel industry was down more than 30 percent from the peak 1974 level and production was off 29 percent for the same period. In the textile industry nearly one-third of the work force has been laid off since 1973, while auto employment is down 15 percent from the boom year of 1979. 25X1

Within the EC, France is the most vocal advocate of a more restrictive trade policy and wants to use increased restrictions to improve its deteriorating trade balance. The French trade deficit grew to nearly $14 billion in 1982—compared to $9.3 billion in 1981—while the balances of most other EC countries showed modest improvement. 25X1

Although the most aggressive, France is not alone in advocating EC protectionism. The British and Belgian Governments have strongly advocated limits on steel imports, and the Dutch are calling for

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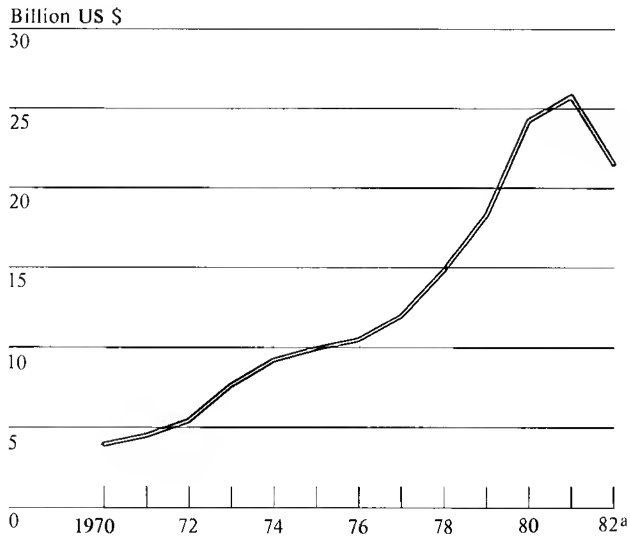
EC: Agricultural Exports



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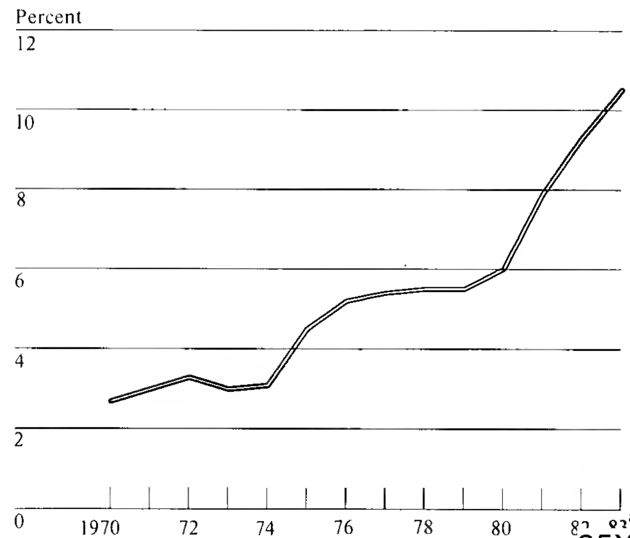
EC: Unemployment Trends



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higher tariffs on electronic products. Although Bonn has not actively supported efforts to restrict access to the EC market, neither has it strenuously opposed new measures. [redacted]

Recent Measures

EC trade policy has become increasingly protectionist in the last six months. At the November GATT ministerial the EC refused to endorse a pledge proposed by the United States not to introduce any new barriers to trade. The Community instead agreed only to refrain from taking or maintaining any measures inconsistent with GATT. Moreover, at the EC heads of government meeting in December, the Ten effectively endorsed a more protectionist stance. Although no specific measures were announced, the leaders apparently gave the go-ahead to an earlier French proposal to seek export restraints on selected Japanese products. [redacted]

EC protectionism is increasingly in the form of new NTBs—particularly VERs. The CCT cannot be raised arbitrarily to fit the trade policy objectives of the Community because all Ten members are signatories to the GATT. The GATT allows for an increase in the duties on covered products only if the Community grants its trading partners corresponding compensatory concessions. VERs, however, are not expressly banned by the GATT. [redacted]

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The EC has directed its recent protectionist measures primarily against those countries, namely Japan and the NICs, that it believes pose the greatest competitive threat to domestic producers. In mid-February, Commission officials secured from Tokyo a three-year VER covering a number of "sensitive" products. Many of these products are produced by the industries the Community is counting on to provide the new jobs necessary to

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European Community:
World and Regional Trade Balances

Million US $

	1970	1975	1980	1981	1982 [a]
World	**−3,908**	**−3,490**	**−57,838**	**−27,458**	**−24,028**
Developed countries	1,261	2,819	−18,977	−10,374	−6,669
United States	−3,031	−8,360	−23,616	−13,827	−10,603
Japan	−270	−3,136	−11,026	−11,635	−11,087
Other	4,562	14,315	15,665	15,088	15,021
LDCs	−6,043	−14,146	−43,462	−20,374	−14,119
Oil-exporting LDCs	−5,523	−15,697	−39,653	−21,550	−12,380
Non-oil-exporting LDCs	−520	1,551	−3,809	1,176	−1,739
Communist countries	304	5,333	−3,541	−4,933	−9,464
Other	570	2,504	8,142	8,223	6,224

[a] Estimated.

[redacted] 25X1

reduce unemployment. The restraint agreement covers color television sets, color television picture tubes, machine tools, quartz watches, video tape recorders (VTRs), passenger cars, light commercial vehicles, motorcycles, and forklift trucks. [redacted]

In general, the agreement does not include specific quantitative limitations but only calls for Japan to moderate its export shipments. The Community interprets this to mean Japan will not attempt to increase its market share in these products above that of 1982. Specific quantitative limits only exist for color television tubes and VTRs. Japanese exports of large color picture tubes will be restricted to 900,000 units because of existing excess capacity in the EC industry. Small picture tubes are not covered by the agreement since the EC does not produce this size tube. [redacted]

On VTRs, the agreement calls for a guaranteed market of 1.2 million units for EC producers and limits Japanese exports to 4.6 million units per year. If the EC market exceeds 5.8 million sets, the excess will go to domestic producers. This arrangement should halt the rapid rise in Japanese penetration of the EC VTR market—last year Japanese exports of VTRs to the Community jumped about 80 percent, giving Japan over 80 percent of the EC market. [redacted] 25X1

In return for Japanese export restraints, the EC has agreed to bring pressure on France to abolish its unique customs clearance requirements for VTRs. Last October, France introduced customs procedures requiring all imported VTRs to be cleared through a single location, the town of Poitiers in west central France. The measure was obviously aimed at slowing down imports from Japan, but it also raised complaints from its EC partners. Not only were Dutch and West German VTR exports likewise required to take this circuitous route, but the potential diversion of Japanese imports to other EC entry points raised fears of additional Japanese penetration in other domestic markets. [redacted] 25X1

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The Community is also concentrating protectionist efforts against LDCs, particularly the NICs. Through use of the MFA, the Community is further tightening import quotas on textiles. The EC is seeking 10-percent quota reductions from

Hong Kong and South Korea; it is not planning to increase quotas for poorer countries as an offset. Despite Turkey's association agreement with the EC, which gives it preferential trade treatment, the Community also is pressing Ankara to limit its cotton textile exports to the EC. [redacted]

Partially in response to US demands for EC limits on steel exports, the Community is attempting to further limit steel imports. Through VERs with 14 of its 15 major supplier countries the Commission is seeking to restrict steel imports to 87.5 percent of the 1980 level of 11.5 million tons; last year imports were held to 90.5 percent of the base year. Although some developed countries are included on this list of countries, the EC appears particularly intent on cutting back imports from the LDCs. To this end, the Community is actively pursuing antidumping investigations against Argentina and Brazil. [redacted]

Prospects

With only marginal improvement in economic activity expected this year and the EC-wide unemployment rate likely to reach 12 percent later in 1983, protectionist pressures within the Community are certain to grow. Nevertheless, we do not believe the Community is likely to adopt significant new trade restrictions in the near term. The conclusion of the VER agreement with Japan has appeased, at least temporarily, those EC members most vociferously calling for Community-wide import restrictions. Moreover, development of a common EC trade policy has never been easy. Now that the generally agreed problems of Japan, steel, and textiles have been addressed, the EC members probably will return to their usual fractious approach to trade policy development. [redacted]

Individual EC countries, however, may well adopt new restrictive measures. Paris, for one, seems intent on more widely applying its French language requirement on the labeling of imports. This independent approach also is reflected in continued French resistance to EC pressure to revise its customs requirements on imported VTRs. Italian, British, and French restrictions on Japanese autos also will not be superseded by the recent EC-Japan 25X1
trade accord. [redacted] 25X1

Implications for the United States

Despite increasing protectionist sentiment among the EC countries, the Community as a group has not yet attempted to restrict US access to the EC market and we believe it is unlikely to do so any time soon, at least not with regard to industrial products. Although the EC's trade deficit with the United States in 1982 was roughly as large as that with Japan—about $11 billion—the deficit with the United States has been cut in half since 1980, 25X1
largely because of a strong dollar. EC industries such as steel and autos are not seriously threatened by US exports, and textiles are already regulated by the MFA. [redacted] 25X1

The Community, however, may move to limit imports of US agricultural products if the US-EC dispute over agricultural export subsidies intensifies. EC members, particularly France, have been infuriated by recent sales of subsidized US agricultural goods to third markets that the EC considers its traditional domain. US sales of subsidized wheat flour to Egypt have effectively blocked EC sales there. Last year, the Community supplied two-thirds of Egypt's wheat flour imports. [redacted] 25X1

With rumors spreading that the United States is considering subsidized butter sales to Egypt as well, EC members are increasingly talking of a head-to-head subsidy war. Such an effort could, in our 25X1
judgment, only be waged for a short time because of the Community's limited resources. Already more than 40 percent of the EC budget goes to agricultural export subsidies. As an alternative, the

French appear to be pushing for restrictions on imports of US agricultural goods—last year the United States had an agricultural trade surplus of $6.6 billion with the EC. Specifically, French Agriculture Minister Cresson has warned that the EC may restrict imports of soybeans and corn gluten. At present, France is receiving little support for such proposals, but further subsidized sales by the United States could cause the other members to come around. 25X1

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West Germany: Keeping Protectionism in Low Gear [redacted] 25X1

The West German Government, traditionally a vocal advocate of free trade, is being pressured by some labor unions and employer groups to adopt protectionist measures. Rising import penetration, record unemployment, and Bonn's perception of growing isolation within the EC on trade policy are working to sap government resistance. The new Kohl government is hoping that a global economic recovery eventually will boost export opportunities and reduce the calls to erect import barriers at home and abroad. In the absence of an upturn, however, we believe Bonn would follow—although not lead—protectionist moves. [redacted]

Long-time Advocates of Free Trade

West German Government and business leaders have consistently spoken out for free trade; [redacted] the West German market is the most open among the major trading nations. The West German Trade Union Confederation (DGB) also officially endorses free trade. West Germany's position arises in part from the belief that free trade benefits the economy, but it primarily is a result of necessity—exports account for one-fourth of West German GNP, and nearly one-fourth of West German workers depend on exports for their livelihoods. Some sectors depend greatly on exports—for example, autos for about 50 percent and machine tools for over 70 percent of sales. West Germans realize how vulnerable they are to retaliation should they erect trade barriers. Finally, as a country that has registered large trade surpluses year after year and that until recently enjoyed steady economic growth and low unemployment, West Germany has had little motivation to resort to trade restrictions. [redacted]

The government of West German Chancellor Helmut Kohl, reelected this past Sunday, has not wavered on free trade. Kohl has stated that West Germany will oppose "all protectionist trading tendencies" from within the EC; he also has promised to speak out against these trends at the Williamsburg Summit in May. Bonn has stressed that increased world trade is essential for lasting economic recovery. This view is shared by the government-sponsored Council of Economic Experts and by the five major economic research institutes. [redacted] 25X1

West German business leaders, representing the entire spectrum of private industry, traditionally have been strong proponents of free trade. Rolf Rodenstock, President of the Association of West German Industries (BDI), believes the fight against both open and hidden forms of protectionism, the elimination of competitive distortions introduced by subsidies, and strict compliance with both the spirit and the letter of GATT regulations are essential. Otto Wolf von Amerongen, President of the West German chamber of commerce (DIHT), echoes Rodenstock as do leaders of the retail trade association and the wholesale and foreign trade associations. [redacted] 25X1

Obstacles to Penetrating the West German Market

With the exceptions of EC actions and an auto restraint agreement with Japan, West Germany has no blatant import limitation agreements. Nevertheless, West Germany has received some criticism for its trade practices. In particular, the exacting West German technical norms and testing procedures (DIN)—considered by many experts to be among the most detailed in the world—have been criticized sharply by the French, who term the

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standards a form of hidden protectionism. The United States is working with the West Germans to smooth standards-related problems, especially in areas where US manufacturers are encountering problems in selling their products. [redacted] 25X1

West German Government procurement, according to Embassy reporting, generally is conducted in accordance with, and in many areas even goes beyond, the provisions of the MTN government procurement code. Exceptions, according to press reporting, are in telecommunications, where "open" tenders always go to the West German firm Siemens. In addition, government tenders for vehicles are rarely advertised, and the national airline—Lufthansa—favors purchases from Airbus over Boeing or McDonnell Douglas. [redacted] 25X1

Government subsidies to domestic industry act to distort trade. West Germany subsidizes its high-cost domestic coal industry; aerospace, agriculture, and a gamut of industries in West Berlin also receive government funds. Most recently, Bonn has interceded in the steel industry to keep tottering Arbed Saarstahl afloat with loan guarantees. The move was justified on the grounds that employment in the locality was heavily dependent on this industry; another steel company, Korf, was allowed to go bankrupt. [redacted] 25X1

Export Promotion

According to the OECD, less than 1 percent of West Germany's 1980 exports were financed on preferential terms. This financing came through the Kreditanstalt fuer Wiederaufbau—used as the official executive agency for West Germany's capital aid to LDCs—and through Ausfuhrkredit GmbH (AKA). AKA is a consortium of some 60 commercial banks that refinances some West German supplier credits through a special rediscount facility at the Bundesbank. [redacted] 25X1

Bonn's principal trade promotion device is the private Hermes AG that provides export credit insurance acting as Bonn's agent; the government bears the ultimate risk. Hermes fees are set for the most part according to commercial criteria, without any direct element of subsidy. Controversy over the role of Hermes, which arose in the context of East-West trade, centered on whether the existence of quasi-government backing for export guarantees encouraged banks and suppliers to go ahead with credits that would not be justified if the risk had to be borne privately. The West Germans vigorously defend Hermes, asserting that although private enterprise should provide such guarantees, it cannot because West Germany's foreign trade is so large relative to the size of the banking system. (West German banks have an aggregate reserve for losses on the order of $9 billion, equal to only about one-sixth of the Hermes guarantees outstanding.) Bonn officials also note that since 1949 the government has made a net profit of about $750 million from the credit insurance operations, and they point out that self-financing guarantee systems are not considered export subsidies according to GATT definitions. [redacted] 25X1

Protectionist Pressures From the EC

Despite Bonn's opposition to the use of formal trade barriers, the government has been feeling increasing presssure to compromise. For example, Bonn feels increasingly isolated as a bastion of free trade within the EC. [redacted] 25X1 25X1 25X1 West Germany hopes to hold the line against French and other member state pressures. France is West Germany's second-largest export market after the Netherlands, and French protectionism—both real and potential—has been a major source of concern of recent West German governments. The West Germans believe they can count on the support of Denmark, the Netherlands, and sometimes the United Kingdom in fending off protectionism. [redacted] 25X1 25X1

The most recent example of EC protectionist pressure on Bonn occurred during the GATT ministerial in November 1982. The West German delegation, for the sake of EC unity, caved in on a final communique far short of the ringing condemnation of protectionism for which the West German delegation had striven. In 1981 West Germany was drawn into the emergency European steel cartel to limit production and make possible higher prices although the West German steel industry is the most competitive in Europe and has done the most to rationalize its production facilities.

Dealing With Japan

There has been wide publicity given to Japan's large surplus in trade with West Germany—$3 billion last year—and to Japanese penetration of the automobile, electronics, and photographic equipment markets. In mid-1981 West German Economics Minister Lambsdorff announced in Tokyo that a voluntary export restraint agreement had been reached with the Japanese Government and auto industry to limit the growth of auto sales to West Germany to 10 percent per year. Until then, Tokyo's sales in West Germany had been doubling annually, rising from a 2-percent share of the market in 1978 to a 10-percent share in 1980. We believe that Bonn was convinced that the Japanese export drive, having been halted elsewhere, would be directed at West Germany; Bonn therefore moved before the Japanese achieved too great a market penetration.

West German Foreign Minister Genscher cautioned Japanese Foreign Minister Abe in January of this year that Japanese reluctance to dismantle trade barriers was hampering West German efforts to dissuade the EC from adopting trade restrictions. West Germany wants to keep pressure on Japan but thus far largely has resisted moves within the EC to restrict trade. West Germany, for example, has refused to go along with attempts by other EC members to fend off Japanese machine tool exports. Rather, many West German Government and industry officials believe that the way to fight the Japanese export drive is through expanding sales to Japan. 25X1

Internal Pressure Building

West Germany is in its longest economic slump since World War II. Bankruptcies are averaging well over 1,000 per month, and the unemployment rate has moved above 10 percent. 25X1 Coupled with EC pressures, calls for protection are increasingly coming from employer and labor organizations alike in the most affected industrial sectors. The West German Iron and Steel Association is pleading for government aid. Beyond citing the well-known plight of the West's steel industry generally, the Association claims its members face an unequal battle against their subsidized competitors in the Community and that EC regulations covering steel quotas, price levels, and imports have been unfairly and insufficiently enforced. The Association is calling on Bonn to pressure the EC Commission to stop subsidies, which it claims redistribute sales at the expense of West German plants. 25X1

The unions whose workers have been most affected by imports have been the most outspoken in seeking protection—the textile workers, the metal workers (who represent the automotive and consumer electronics sectors) and the leather workers. As in other West European countries, the West German textile industry has suffered steady losses in employment 25X1 while import penetration has increased. The textile union was upset when Bonn announced in 1981 that it would not seek a more restrictive multifiber agreement (MFA) in the upcoming negotiations. When the head of the union was unsuccessful in persuading either Chancellor Schmidt or Economics Minister Lambsdorff that the industry needed more protection, the union organized a series of rallies to publicize its cause. The West German union also joined with other EC textile unions, held joint press conferences, and met with key EC

officials just before the opening of the MFA negotiations. In the end, West Germany changed its position and joined other EC countries in setting lower import growth rates for textiles. The West German union chief claimed that without these extraordinary efforts the Bonn government would have remained adamant in resisting tighter controls.

The 2.6-million-member metal worker's union, West Germany's largest, was instrumental in having Lambsdorff sent to Tokyo in 1981 to work out the voluntary restraint agreement on autos. The metal workers in the consumer electronics end of the industry, where job losses and plant closings have sparked a great deal of press interest, have held a series of seminars to dramatize the plight of their industry. The union worked out a common statement with the consumer electronics manufacturers association calling for a three-year limit on imports. The West German Government has thus far resisted the calls for protection, although the industry has regular consultations with the Japanese manufacturers on the level of imports in this sector.

The leather workers union, whose members have been hard hit by import competition, has similarly sought publicity to try to influence the government. The union president also has lobbied top Economics Ministry officials. On the international front, the union has been talking with its European and US counterparts. Jointly, they have launched a campaign for a world shoe agreement, similar to the MFA.

Outlook

Actions by Bonn in the last few years indicate that its traditional support of free trade has weakened slightly in the face of high unemployment at home and signs of increasing protectionism within the EC and elsewhere. Nonetheless, the Kohl government, the bulk of the West German bureaucracy—especially the conservative Economics Ministry—the business community, and the great majority of academics still see West German industry benefiting from free trade. Although some doubts have crept in during the recession, West Germans believe that their low inflation, reliable labor force, and the quality of their products will allow them to beat the competition—especially in Europe. Judging from articles in their press the West Germans have greater doubts about keeping up with the United States and Japan, especially in the technology race. Even in this regard, suggestions for overcoming any disparities are largely in the direction of making West German management more dynamic and willing to adopt new production methods rather than calling for import barriers.

The drop in oil prices and signs that the US economy is gaining momentum give Bonn greater optimism that the West German economy will turn up later this year. These economic trends also brighten the outlook for the growth in world trade, which will further encourage Bonn to hold the line on protectionism. Only if the recovery stumbles might Bonn be forced to compromise its position and occasionally yield to protectionist pressure, but largely as countermeasures.

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The Soviet Economy in 1982

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The Soviet economy grew by 2 percent in 1982; farm output improved, while industrial growth continued to deteriorate. Agricultural performance varies widely from year to year, impacting heavily on annual growth rates, but it is industrial performance that determines the growth path for the economy. Thus the slide in industrial growth and labor productivity bodes ill for the long term.

Industrial growth faltered again as the erosion of growth in labor productivity, transportation bottlenecks, and shortages of raw materials and power took their toll. The important "growth" sectors—machinery, metals, construction materials, and chemicals—all did poorly compared to past performance. The food industry did substantially better in 1982, reflecting the upturn in farm output.

The ***fuels sector*** turned in a mixed performance. Gas production grew fastest at 8 percent, while coal production rebounded from a decline in 1981 to modest growth last year. Oil production rose less than 1 percent despite massive investments; we believe the long-awaited cresting of oil production may be beginning.

Agricultural production grew at a modest 3 percent despite a fourth consecutive poor year for grain. The boost in output was due mainly to record harvests of fruits and vegetables and some improvement in production of potatoes, sugar beets, and sunflower seeds.

At the May 1982 "Food Plenum," Brezhnev set forth a lengthy program aimed at expanding flows of machinery, fertilizer, and other producer goods to farms, but no apparent shift in priorities in favor of agriculture has yet taken place.

USSR: Growth of Selected Industrial Sectors *Percent*

	1971-75 [a]	1976-80 [a]	1981	1982
Ferrous metals	4.0	1.0	−0.1	−0.9
Nonferrous metals	5.9	2.3	1.3	0.8
Electric power	7.0	4.5	2.5	3.0
Machinery	8.0	5.0	3.4	3.8
Chemicals	8.6	3.6	4.0	1.6
Wood products	2.6	−0.3	2.3	1.4
Construction materials	5.4	1.2	1.4	−1.4
Light industry	2.7	2.7	1.9	−0.1
Food industry	3.9	1.1	1.9	2.8

[a] Average annual rate of growth.

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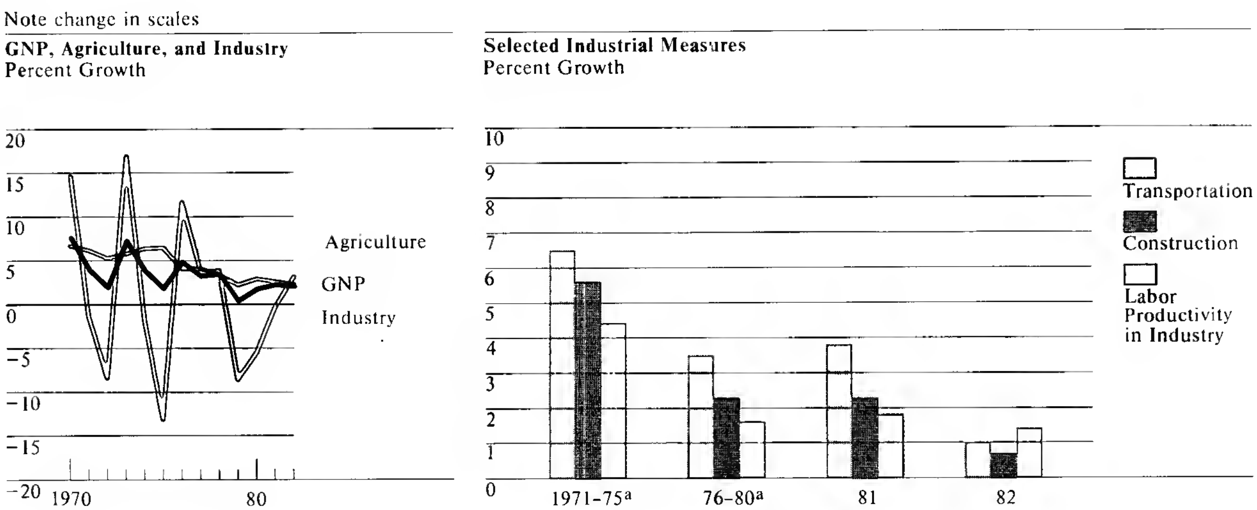
The regime's success in maintaining domestic supplies of livestock products since 1978 has relied on a sharp rise in meat and feedstuffs.

Most ***other producing sectors*** turned in poor performances in 1982:
- The transportation sector did especially badly. Soviet railroads carried less freight despite increased demand.
- The construction sector was plagued by shortages of raw materials and supply bottlenecks.
- Retail trade on a per capita basis failed to grow at all, reflecting the slow growth in the availability of consumer goods.

USSR: Indicators of Economic Growth



[a] Average annual rate of growth.

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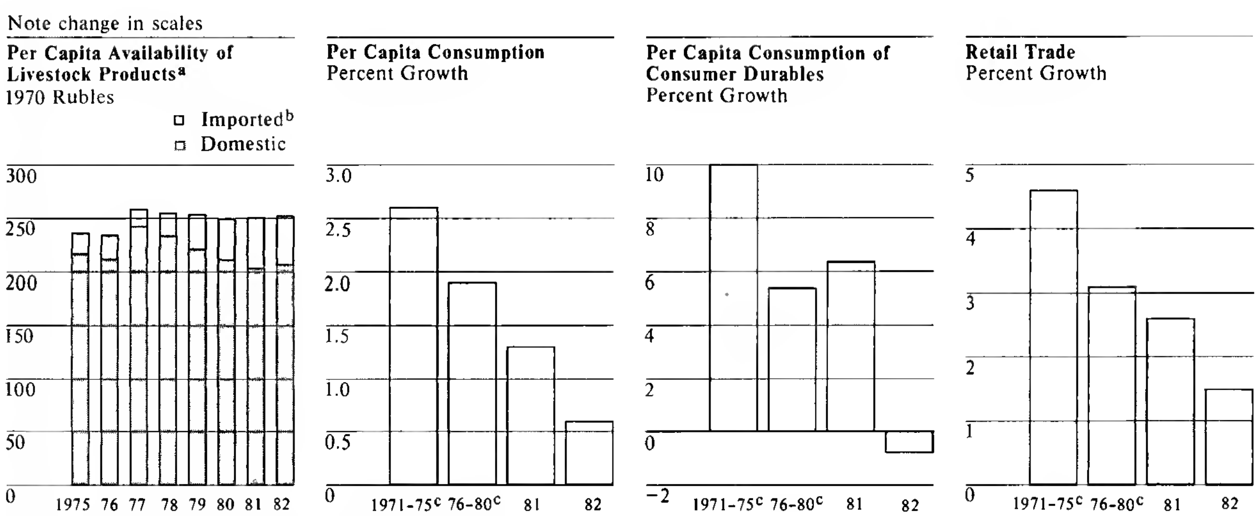
USSR: Growth in the Consumer Sector



[a] Unadjusted for inventory changes and exports.
[b] Including value of imported products of agricultural commodities used in the domestic output of livestock products.
[c] Average annual rate of growth.

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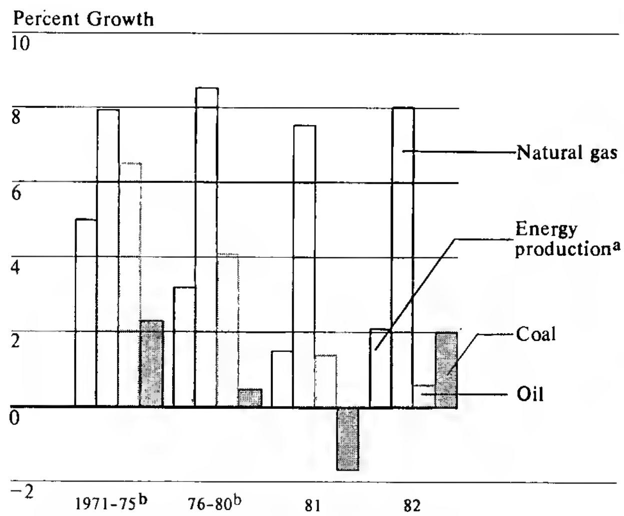
USSR: Estimated Hard Currency Debt to the West

Billion US $ yearend

	1980	1981	1982 [a]
Gross debt	17.9	20.0	20.3
Commercial debt	10.0	12.1	11.6
Government and government-guaranteed debt	7.9	7.9	8.7
Assets in Western banks	8.6	8.4	8.4
Net debt	9.3	11.6	11.9

[a] Estimated.

USSR: Energy Production



[a] Oil, natural gas, and coal production.
[b] Average annual rate of growth.

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Consumer welfare virtually stagnated, providing Andropov justification for moving to restore discipline in the workplace. There was almost no growth in per capita food consumption, and meat consumption fell for the second straight year. For the first time since World War II per capita sales of consumer durables actually declined, reflecting the low priority given to producing consumer goods.

Faltering machinery output is constraining the production of ***defense equipment, new capital equipment,*** and ***consumer durables.*** Although we do not know how defense procurement fared in 1982, it appears from public and private grumblings that defense advocates were not satisfied. Soviet data indicate that new fixed investment rose slowly last year, and as noted above, per capita availability of consumer durables declined in 1982.

Hard Currency Payments Position

The Soviets had considerable success in curbing growth in their hard currency debt in 1982. Although their debt service ratio is relatively small—less than 20 percent—a natural conservatism, heightened by the Polish example, made and will continue to make Soviet financial planners wary of increasing their foreign debt.

Moscow's success in controlling its debt was purchased at substantial cost. The USSR increased hard currency exports of goods (especially oil) needed for domestic use and for sale to its allies and reduced imports of Western goods (especially machinery and industrial materials) sorely needed for economic growth. The Soviets will find it increasingly difficult to sustain favorable trade trends in the coming years, particularly if oil prices continue soft.

Prospects

Andropov's efforts to improve labor productivity through his "disciplinary campaign" probably will

lead to a more rapid growth in industrial output in the short run. This, together with average to good weather, could well boost GNP in 1983. The outlook in 1984 and beyond, however, will be clouded by continued shortages of industrial materials and transportation and smaller additions to the labor force.

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